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THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA

DOCKET NO. 2021-324-WS

IN RE: Application of Kiawah Island Utility, Incorporated to File Proposed Changes in Rates, Charges, Classifications and/or Regulations for Water and Sewer Service	)))))	**REBUTTAL TESTIMONY OF MUJEEB HAFEEZ**

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Mujeeb Hafeez. My business address is 12535 Reed Road, Sugar Land, TX 77478.

Q. ARE YOU THE SAME MUJEEB HAFEEZ WHO PREVIOUSLY PROVIDED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to address certain aspects of testimony filed by Dawn Hipp on behalf of the Office of Regulatory Staff ("ORS") relating to Kiawah Island Utility, Inc.'s ("KIU" or "Company") requested recovery of the allocated costs of SouthWest Water Company's ("SouthWest") executive compensation and corporate development function. If I do not respond to each and every issue in ORS testimony, that should not be understood to imply agreement with them.

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I. EXECUTIVE COMPENSATION

Q. PLEASE SUMMARIZE ORS'S RECOMMENDED ADJUSTMENTS TO SOUTHWEST'S EXECUTIVE COMPENSATION.

A. ORS proposes to remove 50% of the amount allocated to KIU related to base salary, benefits, and taxes for the four highest compensated SouthWest executives. ORS Witness Hipp raises two primary arguments in support of this adjustment. The first is the assertion that executive compensation provides benefits to both shareholders and customers, and there is a "tension" between these interests. For this reason, ORS Witness Hipp suggests that a cost sharing is appropriate. Second, she cited the findings of this and other commissions requiring utilities to share the cost of executive compensation.

Q. DO YOU AGREE WITH ORS WITNESS HIPP'S ASSERTION THAT THERE IS A "TENSION" BETWEEN THE BENEFITS PROVIDED TO CUSTOMERS AND SHAREHOLDERS FROM EXECUTIVE COMPENSATION?

A. No. ORS Witness Hipp stated in her direct testimony that "Executives and officers hold a fiduciary duty to the company's shareholders and owners. The fiduciary duty produces a tension between maximizing returns for shareholders and/or owners and minimizing the financial impact of utility operations and management decisions on the customers who are entitled to reliable service at the lowest reasonable rates" (Direct Testimony of Dawn Hipp page 15, lines 19-21, and page 16, lines 1-3). In reality, SouthWest's executives have a fiduciary duty to its shareholder ***and*** to customers.

When the central focus of the shareholder is ensuring customer satisfaction and welfare by providing the best service at the most reasonable possible price, which the management of regulated utilities is required by statute to do, the interests of the shareholder and the customers are exactly aligned. This alignment becomes more apparent when considering the necessity, for the customers' benefit, for a utility to attract both high-quality management and leadership positions, and to attract financial capital in support of a capital-intensive industry.

Additionally, SouthWest is a privately-held company. Therefore, the functions of its executives differ from those of publicly-traded corporate executives whose job focus may very well be much more on benefits to the shareholders. To the contrary, SouthWest executive management is responsible for providing strategic vision and guidance, business strategy and development, executive management and oversight, and the overall direction of the company which benefits customers and shareholders alike.

Attracting capital from investors is vital to fund the capital requirements of water and wastewater utilities. One of the key benefits of a smaller utility being part of a larger parent company is the access to capital that the parent is able to provide. The ability to maintain and support high-quality service to customers at a reasonable cost is inseparably linked to the executives' ability to meet shareholder expectations. Absent SouthWest executive support and services, KIU would neither be positioned to

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meet the needs of its customers nor be able to achieve financial returns that attract debt and equity capital needed for the financial welfare of the utility.

Q. DID KIU ALREADY REMOVE FROM ITS REQUESTED REVENUE REQUIREMENT THE PORTION OF EXECUTIVE COMPENSATION ASSOCIATED WITH SHAREHOLDER INTERESTS?

A. Yes. Certain portions of SouthWest's executive incentive compensation are based on the company's financial performance. However, KIU, through its prudent consideration, has removed from its application 100% of all compensation that is tied to financial performance. Therefore, KIU is not seeking to recover any costs that could ***even be perceived*** as providing benefit solely to the shareholder.

Q. DOES ORS WITNESS HIPP PROVIDE ANY SPECIFIC ANALYSIS OR FINDINGS REGARDING SOUTHWEST EXECUTIVES?

A. No. ORS Witness Hipp makes general and broad statements about the theoretical roles and duties of executive management. However, ORS Witness Hipp does not identify any specific SouthWest executive position or duty which is for the exclusive benefit of the shareholder. The adjustment to exclude 50% of KIU's share of the costs of SouthWest's executive compensation is arbitrary and lacks support in the reality of the functions of SouthWest's executive team. Additionally, as noted above, since KIU has already removed executive compensation based on financial performance, ORS's adjustment to remove 50% of ***requested*** executive compensation is ***effectively removing more than 50%*** of SouthWest's total executive compensation. Said

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differently, executive compensation has already been adjusted and does not require further modifications to meet Witness Hipp's assertion.

Q. ORS WITNESS HIPP REFERENCES FINDINGS OF THIS AND OTHER COMMISSIONS ALLOWING A SHARING OF THE COST OF EXECUTIVE COMPENSATION. PLEASE EXPLAIN WHY THESE REFERENCES ARE NEITHER RELEVANT TO NOR APPROPRIATE FOR KIU.

A. ORS Witness Hipp states "Some commissions do not permit utilities to charge customers for incentive plans and payments designed to drive earnings. Commissions who have addressed these issues often employ a 50/50 sharing of the costs between shareholders and customers or disallow a portion of the costs that are tied to financial performance" (Direct Testimony of Dawn Hipp page 16 lines 19-21, and page 17, lines 1-2). ORS Witness Hipp cites page 19 and Appendix MG-3 of the testimony of Mark E. Garrett, dated August 20, 2019 in Cause No. 45235 before the Indiana Utility Regulatory Commission[1] in support of this conclusion. However, in his testimony, Mark Garrett is referring to how commissions have addressed issues relating only to ***incentive*** compensation. He states, "While some states disallow ***incentive pay*** using other criteria, and some states apply a sharing mechanism such as a 50%-50% allocation, none of the jurisdictions surveyed allow full recovery of ***incentive***

[1] See Testimony of Mark E. Garrett in Cause No. 45235 before Indiana Utility Regulatory Commission available at: https://www.in.gov/oucc/files/45235MarkGarrett.pdf

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compensation through rates as a general rule."[2] As mentioned above, KIU removed all incentive compensation based on financial performance from its application. ORS Witness Hipp's reference to Mark Garrett's testimony, which refers solely to incentive compensation, is not appropriate or relevant to this proceeding, given the ORS-proposed adjustment to KIU is a reduction of 50% of ***all*** executive compensation, including salary, benefits, and taxes. As stated previously, SouthWest's financial-based incentive compensation has already been removed. Witness Hipp's proposal would be a reduction upon a reduction of executive compensation.

Next, Witness Hipp refers to Commission Order No. 2019-729 stating, "the Commission accepted ORS's recommendation to remove 50% of the base pay and benefits paid to Dominion Energy South Carolina's ("DESC") four highest compensated executives in the 2019 DESC Application under the Rate Stabilization Act" (Direct Testimony of Dawn Hipp page 17 lines 4-7). However, ORS's recommendation was based on its finding that the DESC "executives' job duties are ***solely focused*** on increasing value for the Company's shareholders and ***provide no discernable additional benefit*** to the Company's customers."[3] Witness Hipp has not suggested that SouthWest's executives provide no discernable additional benefit to

[2] See page 10 of Testimony of Mark E. Garrett in Cause No. 45235 before Indiana Utility Regulatory Commission – available at: https://www.in.gov/oucc/files/45235MarkGarrett.pdf

[3] See pages 4-5 of ORS's 2019 Review of Dominion Energy South Carolina, Inc.'s Gas Rate Stabilization Act Monitoring Report – available at: https://dms.psc.sc.gov/Attachments/Matter/bd425425-d5a6-4a56-b5ee-606b61105cc5

KIU's customers, yet is proposing the same adjustment accepted by the Commission in Order No. 2019-729. In reality, SouthWest's executives play a key role in the successful operation of KIU, benefiting customers and shareholders alike, and ought not receive the same cost recovery outcome as an executive team that is solely focused on increasing value for its company's shareholders. Based on these reasons, ORS Witness Hipp's reference to Commission Order No. 2019-729 is not appropriate or relevant to this proceeding.

Finally, ORS Witness Hipp refers to Commission Order No. 2019-341 stating, "In both the Duke Energy Carolinas ("DEC") and the Duke Energy Progress ("DEP" collectively "Duke Energy") general rate proceedings, the Commission ordered adjustments to remove seventy-five percent of the compensation paid to Duke Energy's highest executive and fifty percent of the compensation paid to the Duke Energy's next three highest executives" (Direct Testimony of Dawn Hipp page 17 lines 11-15). These Commission-ordered adjustments were an extraordinary measure and were directly in response to what the Commission considered to be a "tone-deaf" executive team. The Commission stated in its directive, "…the CEO and executive team demonstrated they were "tone deaf" as to how a 238% increase in the Basic Facilities Charge would have negatively and adversely impacted the elderly, the disabled, the low income and low use customers. It is one of the reasons I am recommending a 75% disallowance of the CEO's excessively high executive compensation for South Carolina during test year

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2017 and a 50% disallowance for the next three highest Company executives."[4] SouthWest does not have this kind of track record, reputation, or history. In fact, ORS has repeatedly recognized the excellent quality of service, financial condition, and operational performance of SouthWest and KIU. As an example, in KIU's last rate case, Jeffrey M. Nelson, ORS Chief Legal Officer at the time, stated the following on the record at the hearing:

> *...I would just like to add that ORS views this as a very good company. A lot of utilities that we regulate, we tend to have a hard time with. Always, when we're dealing with Kiawah and SouthWest, they've been very cooperative in providing the information to us, answering any requests that we have, and willing to give some give-and-take, too, as we're going through these rate cases. So, I just wanted to take the chance to say how much we appreciate their doing business in South Carolina.*

Moreover, the Commission directive refers to the compensation of Duke Energy's CEO and next three highest executives as "excessive." As I stated in my Direct Testimony, a recent benchmarking study finds that even when including the financial-based compensation that has been removed from this filing, SouthWest's total executive compensation is within the median market competitive range (i.e. clearly not

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[4] See Public Service Commission of South Carolina Commission Directive dated May 01, 2019 – available at https://dms.psc.sc.gov/Attachments/Matter/1bd82215-b824-425a-9291-f5e9bbc8441b

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excessive). Based on these reasons, ORS Witness Hipp's reference to Commission Order No. 2019-341 is not appropriate or relevant to this proceeding.

Q. ORS RECENTLY REVIEWED THE APPLICATION OF PALMETTO WASTEWATER RECLAMATION, INC. IN DOCKET 2021-153-S. DID ORS PROPOSE AN ADJUSTMENT IN THAT DOCKET TO REMOVE 50% OF SOUTHWEST EXECUTIVE COMPENSATION?

A. No. ORS did not propose any adjustment to SouthWest's executive compensation in Docket 2021-153-S. The SouthWest allocable costs for executive compensation included in Docket 2021-153-S are the ***same costs for the same test year*** as this application. In Docket 2021-153-S, ORS concluded that SouthWest's allocable corporate costs (including executive compensation) were reasonable and appropriate for recovery by stating that they will evaluate future dockets to ensure that the costs "***continue to be*** reasonable, beneficial for customers, and appropriate for recovery in rates."[5] This inconsistency in conclusion/adjustment suggests that ORS is perhaps reaching to propose an unwarranted and arbitrary adjustment simply to lower KIU's revenue requirement in this application.

For all of the reasons presented above, it is clear that SouthWest's executive compensation is a vital component of KIU's cost of service. It is critically important

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[5] See Docket 2021-153-S, Direct Testimony of Christina L. Seale, page 10, lines 13-17

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that KIU be able to recover its costs, earn a fair return, and pay its creditors in order to maintain quality of service which is in the interest of customers.

II. CORPORATE DEVELOPMENT

Q. WHAT IS ORS PROPOSING WITH RESPECT TO THE ALLOCATED COST OF SOUTHWEST'S CORPORATE DEVELOPMENT TEAM?

A. ORS proposes to remove all expenses allocated to KIU related to SouthWest's Corporate Development Team ("Team").

Q. ORS WITNESS HIPP STATES THAT THE TEAM WAS ESTABLISHED BY SOUTHWEST AFTER THE TEST YEAR ENDED; IS THIS CORRECT?

A. No. The Team was not formed after the end of the Test Year, but has existed since 2015. Since its formation, the Team has been directly responsible for significant growth to the SouthWest business, including expanding its utility operations into three new states and including SouthWest's acquisition of KIU in 2016. This continued growth allows customers to benefit from greater economies of scale as the costs of SouthWest's corporate functions are spread over a larger base of utilities and customers. KIU customers will continue to benefit from SouthWest's future growth over time by receiving SouthWest's robust corporate services, which they could surely not obtain on their own, at proportionally lower costs.

Q. ORS WITNESS HIPP STATES THAT THE BENEFITS TO KIU CUSTOMERS AS A RESULT OF THE TEAM ARE SPECULATIVE AND THAT KIU HAS

NOT SHOWN A NET BENEFIT TO CUSTOMERS. HOW DO YOU RESPOND?

The direct benefit of the Team to KIU customers is certainly not speculative. As noted in my Direct Testimony, SouthWest's allocable corporate costs are allocated using a three-factor methodology. The three-factor allocation to KIU was 5.2% at the time of KIU's last rate case. In the current application, as a direct result of the Team's successful growth efforts, the three-factor allocation percentage is now 4.3%. This represents a decrease of 90 basis points, or an approximate reduction of $125,000 of Test Year corporate costs allocated to KIU. The cost of the Team allocated to KIU in this application is approximately $46,000. This results in an approximate net savings of $76,000 from which KIU customers are benefitting, which they would not have absent the Team's efforts.

Moreover, ORS is proposing that the three-factor allocation percentage be updated for SouthWest's acquisitions after the Test Year, including six that have closed and one that has ***yet to close***. Such an adjustment would reduce KIU corporate allocations by an approximate additional $28,000, which would yield a net savings of over $100,000 to customers since KIU's last rate case. By imputing acquisitions closed subsequent to the Test Year and even proposing to go so far as including an acquisition that has yet to close, ORS is clearly acknowledging that the Team's efforts are more than speculative. ORS's adjustment to remove all expenses allocated to KIU from the

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Team would result in customers benefiting from SouthWest's growth, but never bearing any of the cost of it.

Witness Hipp's assertion that KIU has not shown a net benefit to KIU customers is based on the misunderstanding that the Team is newly formed, and therefore, she has incorrectly not attributed SouthWest's growth since KIU's last application to the Team.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

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